

S  
352.44  
L72MLOA  
1996

MONTANA STATE LOTTERY  
FINANCIAL STATEMENTS

Years Ended June 30, 1996 and 1995

STATE DOCUMENTS COLLECTION

FEB 21 1997

MONTANA STATE LIBRARY  
1515 E. 6th AVE.  
HELENA, MONTANA 59620

PLEASE RETURN



Prepared Under Contract With:  
**MONTANA LEGISLATIVE BRANCH, AUDIT DIVISION**  
PO Box 201705, Helena, MT 59620-1705

MONTANA STATE LIBRARY



3 0864 0009 8061 8



MONTANA STATE LOTTERY

FINANCIAL STATEMENTS

Years Ended June 30, 1996 and 1995

OLNESS & ASSOCIATES, P. C.

CERTIFIED PUBLIC ACCOUNTANTS

801 15TH STREET WEST  
PO BOX 23398  
BILLINGS, MONTANA 59104-3398  
(406) 252-6230  
TOLL FREE (800) 814-9516  
FAX (406) 245-6922



## TABLE OF CONTENTS

	Page No.
TRANSMITTAL LETTER FROM THE OFFICE OF THE LEGISLATIVE AUDITOR .....	1
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS .....	2
INTRODUCTION AND BACKGROUND .....	3
INDEPENDENT AUDITOR'S REPORT .....	4
FINANCIAL STATEMENTS	
Balance Sheets .....	5
Statements of Revenues, Expenses and Changes in Retained Earnings .....	6
Statements of Cash Flows .....	7
Notes to Financial Statements .....	9
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <u>GOVERNMENT AUDITING STANDARDS</u> .....	16
INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <u>GOVERNMENT AUDITING STANDARDS</u> .....	18



# MONTANA LEGISLATIVE BRANCH

*Legislative Auditor*  
*Scott A. Seacat*

Legal Counsel:  
John Northey



Deputy Legislative Auditors:  
Mary Bryson  
Operations and EDP Audit  
James Gillett  
Financial-Compliance Audit  
Jim Pellegrini  
Performance Audit

## LEGISLATIVE AUDIT DIVISION

September 1996

The Legislative Audit Committee  
of the Montana State Legislature

Enclosed is the report on the audit of the Montana State Lottery for the year ended June 30, 1996.

The audit was conducted by Olness and Associates, PC, under a contract between the firm and our office. The comments and recommendations contained in this report represent the views of the firm and not necessarily the Legislative Auditor.

The report contains no recommendations. Therefore, the agency did not provide a response.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott Seacat", is written over a horizontal line.

Scott Seacat  
Legislative Auditor

96C-06





MONTANA STATE LOTTERY  
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS  
JUNE 30, 1996

COMMISSION MEMBERS

Rebecca Erickson, Chairman

Clifford Brophy

Larry O'Toole

David Kasten

Robert Crippen

RESIDENCE

Glasgow

Columbus

Plentywood

Brockway

Butte

ADMINISTRATIVE OFFICIALS

Jerry LaChere, Montana State Lottery Director

L. John Onstad, Director of Security

Leslie J. Darfler, Director of Operations

Vacant as of June 30, 1996, Director of Marketing



MONTANA STATE LOTTERY  
INTRODUCTION AND BACKGROUND

JUNE 30, 1996

INTRODUCTION

The purpose of our contract with the State and Montana State Lottery was to conduct a financial-compliance audit of the Montana State Lottery's financial statements and issue an opinion on such. The scope of our services is defined in our contract with the Office of the Legislative Auditor, dated June 27, 1994, and as supplemented by certain requirements included in the bidder information.

As a result of our audit, we have issued an independent auditor's report on internal control structure and an independent auditor's report on compliance with laws and regulations, which include certain required comments per the contract.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the Montana Session Laws and Title 23, Chapter 7, of the Montana Code Annotated. The general purpose is to allow lottery games in which players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. Effective July 1, 1995, the Montana State Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Prior to July 1, 1995 net revenues were transferred to the Montana Office of Public Instruction and the Montana Board of Crime Control.



# OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

ERNEST J. OLNESS, CPA

801 15TH STREET WEST  
PO BOX 23398  
BILLINGS, MONTANA 59104-3398  
(406) 252-6230  
TOLL FREE (800) 814-9516  
FAX (406) 245-6922

## INDEPENDENT AUDITOR'S REPORT

To the Commissioners  
Montana State Lottery  
Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 1996 and 1995, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued a report dated August 29, 1996, on our consideration of the State of Montana's internal control structure as it relates to the Montana State Lottery and a report dated August 29, 1996, on its compliance with laws and regulations.

*Olness & Associates, PC*

August 29, 1996



MONTANA STATE LOTTERY  
BALANCE SHEETS  
June 30, 1996 and 1995

	<u>1996</u>	<u>1995</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (note 2)	\$ 2,482,222	\$ 2,647,262
Accounts receivable, less allowance for doubtful receivables of \$ -0- in 1996 and \$8,453 in 1995	763,372	525,276
Inventory	166,963	393,848
Other current assets (note 3)	<u>23,468</u>	<u>64,781</u>
TOTAL CURRENT ASSETS	<u>3,436,025</u>	<u>3,631,167</u>
FIXED ASSETS		
Furniture, fixtures and equipment	692,935	1,042,093
Accumulated depreciation and amortization	<u>(358,169)</u>	<u>(662,490)</u>
	<u>334,766</u>	<u>379,603</u>
OTHER ASSETS		
Long-term receivable (note 4)	<u>1,721,065</u>	<u>1,461,589</u>
	<u>\$ 5,491,856</u>	<u>\$ 5,472,359</u>
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 304,801	\$ 225,639
Estimated prize liability (note 5)	1,208,856	694,416
Transfer obligations (note 6)	1,645,131	2,376,243
Other current liabilities (note 7)	<u>273,729</u>	<u>324,665</u>
TOTAL CURRENT LIABILITIES	<u>3,432,517</u>	<u>3,620,963</u>
LONG-TERM LIABILITIES (note 8)	<u>1,820,296</u>	<u>1,564,893</u>
	<u>5,252,813</u>	<u>5,185,856</u>
FUND EQUITY		
Contributed capital (note 10)	239,043	239,043
Retained earnings	<u>-</u>	<u>47,460</u>
	<u>239,043</u>	<u>286,503</u>
COMMITMENTS AND CONTINGENCIES (notes 9 and 13)	<u>-</u>	<u>-</u>
	<u>\$ 5,491,856</u>	<u>\$ 5,472,359</u>





MONTANA STATE LOTTERY  
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS  
Years Ended June 30, 1996 and 1995

	<u>1996</u>	<u>1995</u>
OPERATING REVENUES		
Instant ticket games	\$ 6,331,627	\$ 7,281,701
On-line games	25,429,787	25,476,717
License fees	<u>2,000</u>	<u>2,700</u>
TOTAL OPERATING REVENUES	<u>31,763,414</u>	<u>32,761,118</u>
COST OF TICKET REVENUES		
Instant ticket prize expense	3,525,849	3,955,212
On-line ticket prize expense	12,388,451	12,196,640
Retailer commission	1,765,565	1,803,629
On-line vendor fees	2,910,743	3,214,013
Cost of tickets sold	<u>383,879</u>	<u>334,186</u>
TOTAL COST OF TICKET REVENUES	<u>20,974,487</u>	<u>21,503,680</u>
NET OPERATING REVENUES	<u>10,788,927</u>	<u>11,257,438</u>
OPERATING EXPENSES		
Advertising	873,088	548,872
Communications	202,699	152,180
Contractual services	385,360	420,587
Depreciation	89,578	60,814
Management fees	91,300	86,151
Multi-state operating fees	82,108	93,288
Personal services	1,170,008	1,105,216
Repairs and maintenance	60,086	73,887
Supplies and materials	116,905	152,583
Utilities and rent	91,461	92,845
Travel	29,056	35,762
Other	<u>49,986</u>	<u>44,848</u>
TOTAL OPERATING EXPENSES	<u>3,241,635</u>	<u>2,867,033</u>
OPERATING INCOME	<u>7,547,292</u>	<u>8,390,405</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	243,019	201,396
Gain (loss) on disposal of fixed assets	<u>(34,709)</u>	<u>2,212</u>
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>208,310</u>	<u>203,608</u>
INCOME BEFORE OPERATING TRANSFERS	<u>7,755,602</u>	<u>8,594,013</u>
OPERATING TRANSFERS OUT		
Montana State General Fund	(7,803,062)	-
Montana Office of Public Instruction	-	(7,811,958)
Montana Board of Crime Control	<u>-</u>	<u>(782,055)</u>
TOTAL OPERATING TRANSFERS	<u>(7,803,062)</u>	<u>(8,594,013)</u>
NET INCOME (LOSS)	(47,460)	-
RETAINED EARNINGS, BEGINNING OF YEAR	47,460	-
Prior period adjustment	<u>-</u>	<u>47,460</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ -</u>	<u>\$ 47,460</u>

See notes to financial statements.



MONTANA STATE LOTTERY  
STATEMENTS OF CASH FLOWS  
Years Ended June 30, 1996 and 1995

	<u>1996</u>	<u>1995</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	\$ 31,255,410	\$ 32,952,758
Cash paid to suppliers for goods and services	(6,675,019)	(7,174,608)
Cash paid to employees	(1,157,084)	(1,079,978)
Cash paid for prizes	<u>(15,227,395)</u>	<u>(16,368,009)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>8,195,912</u>	<u>8,330,163</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
Montana State General Fund	(8,534,174)	-
Montana Office of Public Instruction	-	(8,066,780)
Montana Board of Crime Control	<u>-</u>	<u>(807,565)</u>
NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES	<u>(8,534,174)</u>	<u>(8,874,345)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from the sale of fixed assets	11,705	10,156
Purchase of fixed assets	<u>(91,155)</u>	<u>(44,874)</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(79,450)</u>	<u>(34,718)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on investments	<u>252,672</u>	<u>202,504</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>252,672</u>	<u>202,504</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(165,040)	(376,396)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>2,647,262</u>	<u>3,023,658</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>\$ 2,482,222</u></u>	<u><u>\$ 2,647,262</u></u>



MONTANA STATE LOTTERY  
STATEMENTS OF CASH FLOWS-continued  
Years Ended June 30, 1996 and 1995

Reconciliation of Operating Income to  
Net Cash Provided by Operating Activities

	<u>1996</u>	<u>1995</u>
Operating income	\$ 7,547,292	\$ 8,390,405
Adjustment to reconcile operating income to net cash provided by operating activities		
Depreciation	89,578	60,814
Changes in assets and liabilities		
(Increase)/decrease in accounts receivable	(238,096)	346,988
(Increase)/decrease in inventory	226,885	(175,601)
Decrease in other current assets	31,660	81,515
Increase in long-term receivable	(259,476)	(330,391)
Increase in accounts payable	79,162	18,718
Increase/(decrease) in estimated prize liability	514,440	(242,242)
Decrease in other current liabilities	(50,936)	(131,614)
Increase in long-term liabilities	<u>255,403</u>	<u>311,571</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 8,195,912</u>	<u>\$ 8,330,163</u>

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

Contributions of fixed assets	\$ -	\$ 237,683
-------------------------------	------	------------



MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commissions to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund.

Reporting Entity

The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when the tickets are delivered to the retailers. Tickets not sold by retailers may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents

Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Inventory

Inventories consist of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when sold. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.





MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS (continued)

Prizes

Prepaid prizes represent prizes purchased and on-hand in advance of game awards. Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Intangible Assets

Intangible assets represent the per ticket cost paid to Automated Wagering Inc. for advance on-line ticket sales. These ticket sales, also referred to as deferred revenue, represent tickets sold prior to June 30, 1996 and 1995 for drawings held subsequent to year-end.

Fixed Assets

Fixed assets are recorded at cost. Donated fixed assets are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of fixed assets, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years.

Contributed Capital

Contributed capital represents equity acquired through contributions from vendors and the State of Montana.

Compensated Absences

State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

NOTE 2 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	June 30,	
	1996	1995
Short-term investment pool	\$ 2,099,672	\$ 2,104,119
Cash on deposit with State Treasurer	372,400	533,403
Cash in revolving deposit account	10,000	9,590
Petty cash	150	150
	<u>\$ 2,482,222</u>	<u>\$ 2,647,262</u>

Reference to the audit of the State of Montana would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$10,889 and \$10,767 at June 30, 1996 and 1995, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.



MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 3 - OTHER CURRENT ASSETS

Other current assets consist of the following:

	June 30.	
	1996	1995
Prepaid prizes and expenses	\$ 9,745	\$ 32,295
Intangible assets	9,423	16,602
Interest receivable on investment pool	-	9,653
Employee advances	4,300	4,300
Other	-	1,931
	<u>\$ 23,468</u>	<u>\$ 64,781</u>

NOTE 4 - MULTI-STATE LOTTERY ASSOCIATION

Joint Venture Association

In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Lotto\*America/Powerball game and the Tri-West Lotto game are presently the only games operated jointly by the members. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable

As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,721,065 and \$1,461,589 at June 30, 1996 and 1995, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$71,230,398 and \$53,509,676 for 1996 and 1995, respectively. The long-term liability balance of \$1,652,728 and \$1,399,705 at June 30, 1996 and 1995, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto\*America Prizes and Investments

Prizes awarded to Lotto\*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 1996 and 1995, MUSL held United States Government zero coupon bonds in trust for the



MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS (continued)

Montana State Lottery winners with respective par values of \$75,414,077 and \$48,671,305 and respective market values of \$46,045,929 and \$30,830,604.

The Montana State Lottery has seven Lotto\*America/Powerball/Tri-West winners. The combined total of future prize payments owed is \$75,413,000 and \$48,671,000 at June 30, 1996 and 1995, respectively. Total annual payments due over each of the next five years is \$4,658,000 annually and \$52,123,000 thereafter. The present value of future prize payments approximate the current market value of the bonds held in trust for the Montana State Lottery winners.

Multi-State Lottery Association Financial Position

Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	June 30,	
	1996	1995
Total assets	<u>\$1,243,916,193</u>	<u>\$ 910,766,450</u>
Total liabilities	1,243,700,474	910,585,456
Total net assets	<u>215,719</u>	<u>180,994</u>
Total liabilities and net assets, unrestricted	<u>\$1,243,916,193</u>	<u>\$ 910,766,450</u>
Total revenues	\$ 2,261,391	\$ 1,917,361
Total expenses	<u>2,226,666</u>	<u>1,894,768</u>
Increase in unrestricted net assets	<u>\$ 34,725</u>	<u>\$ 22,593</u>

NOTE 5 - ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE 6 - OBLIGATION TO TRANSFER FUNDS

Beginning July 1, 1992, the Lottery was required to transfer, each quarter, 9.1 percent of income before transfers to the Montana Board of Crime Control. The balance of income before transfers was transferred to the Montana Office of Public Instruction. Effective July 1, 1995, the Montana State Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. The following is a summary of total transfer obligations outstanding:

	June 30,	
	1996	1995
Transfer obligation - Montana Board of Crime Control	\$ -	\$ 216,238
Transfer obligation - Montana Office of Public Instruction	-	2,160,005
Transfer obligation - Montana State General Fund	<u>1,645,131</u>	<u>-</u>
Total transfer obligations	<u>\$ 1,645,131</u>	<u>\$ 2,376,243</u>



MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS (continued)

NOTE 7 - OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	June 30.	
	1996	1995
Estimated return ticket liability	\$ 58,321	\$ 86,884
Due to other state agencies	133,468	93,414
Deferred on-line revenue	81,940	144,367
	<u>\$ 273,729</u>	<u>\$ 324,665</u>

NOTE 8 - LONG-TERM LIABILITIES

Long-term liabilities consist of the following:

	June 30.	
	1996	1995
Prize liability Multi-State Lottery Association	\$ 1,652,728	\$ 1,399,705
Accrued compensated absences	167,568	165,188
	<u>\$ 1,820,296</u>	<u>\$ 1,564,893</u>

NOTE 9 - LEASES

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 1997. Rent expense under operating leases charged to operations was \$78,000 for the years ended June 30, 1996 and 1995.

NOTE 10 - CONTRIBUTED CAPITAL

The following changes occurred in contributed capital:

	June 30.	
	1996	1995
Beginning balance, contributed capital	\$ 239,043	\$ 1,360
Donated fixed assets	-	237,683
	<u>\$ 239,043</u>	<u>\$ 239,043</u>

NOTE 11 - EMPLOYEE BENEFIT PLANS

Pension Plan

The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees





MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS (continued)

Retirement System, Public Employees Retirement Division, P.O. Box 200131, 1712 Ninth Avenue, Helena, MT 59620-0131, (406) 444-3154.

Contribution rates for the plan are required and determined by State law. Contribution rates for the Lottery and its employees were increased from 6.55% to 6.70% effective July 1, 1993. The contribution rate for 1996, expressed as a percentage of covered payroll, for both the employer and employee was 6.7%.

The amounts contributed to the plan during the years ended June 30, 1996, 1995 and 1994, were \$117,222, \$109,114 and \$117,963, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan

The Lottery's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The State of Montana administers the plan by contractual arrangement with Nationwide Insurance. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts deferred under the plan created under Internal Revenue Code Section 457 remain the property of the State of Montana until paid, subject only to claims of the State of Montana's general creditors. Participants' rights under the plan are equal to those of general creditors of the State of Montana in an amount equal to the fair market value of the deferred account for each participant.

NOTE 12 - RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 1996 and 1995, total payments to other State agencies were approximately \$1,585,233 and \$1,383,177, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Instant Tickets

The Lottery has signed agreements to purchase instant game tickets from Dittler Brothers, Inc., through June 1997. The Lottery has the option to extend the agreement for an additional four, one-year periods.

Maintenance Contract

The Lottery has signed an agreement for computer hardware and software maintenance with Stratus Computer, Inc., for \$3,528 per month. The agreement may be canceled by either party with proper notification.

On-line Vendor

The Lottery has signed a contract with Automated Wagering International, Inc., a wholly owned corporation of Video Lottery Technologies, Inc., to provide on-line terminals, central computers and a telecommunications network through November 1998. The contract provides for payments to be based on a percentage of weekly sales.

Prize Contingencies

Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery



MONTANA STATE LOTTERY  
NOTES TO FINANCIAL STATEMENTS (continued)

that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$2,734,559 and \$2,984,559 at June 30, 1996 and 1995, respectively, if the insurance carrier defaulted on their payments.

Advertising

The Lottery signed a contract with Wendt Advertising to provide advertising services for \$12,750 per month through September 1996.

**NOTE 14 - PRIOR PERIOD ADJUSTMENT**

The prior period adjustment of \$47,460 reflects a correction to the MUSL prize reserve accounts related to fiscal year ended June 30, 1992.



# OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

ERNEST J. OLNESS, CPA

801 15TH STREET WEST  
PO BOX 23398  
BILLINGS, MONTANA 59104-3398  
(406) 252-6230  
TOLL FREE (800) 814-9516  
FAX (406) 245-6922

## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Commissioners  
Montana State Lottery  
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 1996, and have issued our report thereon dated August 29, 1996.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of Montana State Lottery is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use of disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of Montana State Lottery, for the year ended June 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk



INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS - continued

that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of Montana State Lottery in a separate letter dated August 29, 1996.

This report is intended for the information of the Lottery's Commissioners, management, and the Legislative Audit Committee. However, this report is a matter of public record and its distribution is not limited.

*O'Leary & Associates, PC*

August 29, 1996





# OLNESS & ASSOCIATES, P. C.

BRENT D. OLNESS, CPA

CERTIFIED PUBLIC ACCOUNTANTS

ERNEST J. OLNESS, CPA

801 15TH STREET WEST  
PO BOX 23398  
BILLINGS, MONTANA 59104-3398  
(406) 252-6230  
TOLL FREE (800) 814-9516  
FAX (406) 245-6922

## INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Commissioners  
Montana State Lottery  
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 1996, and have issued our report thereon dated August 29, 1996.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts and grants applicable to Montana State Lottery is the responsibility of the Lottery's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of Montana State Lottery's compliance with certain provisions of laws, regulations, contracts and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information of the Lottery's Commissioners, management, and the Legislative Audit Committee. However, this report is a matter of public record and its distribution is not limited.

*Olness & Associates, PC*

August 29, 1996





